

Message Text

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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC): REVIEW OF THE UNITED STATES

FOLLOWING IS FINAL TEXT OF MAIN ISSUES PAPER FOR EDRC
EXAMINATION OF THE U.S.:

BEGIN TEXT

IN THE LIGHT OF THE DISCUSSION IN THE DRAFT SURVEY, THE
COMMITTEE MAY WISH TO CONCENTRATE ITS DELIBERATIONS ON
THE INFLATION ISSUE, DEMAND MANAGEMENT AND THE BALANCE-
OF-PAYMENTS PROBLEM.

I. DOMESTIC DEVELOPMENTS

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1. THE U.S. DELEGATION MAY WISH TO COMMENT ON THE
SECRETARIAT'S FORECAST FOR 1978/79, WHICH FORESEES A
MARKED SLOWDOWN IN THE PACE OF ACTIVITY OVER THE NEXT
TWELVE MONTHS AND CONTINUING HIGH RATES OF INFLATION.

INFLATION

2. THE COMMITTEE MAY WISH TO DISCUSS HOW FAR ACCELERATION IN THE RATE OF INFLATION SINCE THE BEGINNING OF THE YEAR REFLECTS UNDERLYING, RATHER THAN PURELY TEMPORARY, FACTORS:

(A) IN THIS CONTEXT, THE U.S. DELEGATION MAY WISH TO ASSESS HOW MUCH OF THE MARKED ACCELERATION IN HOURLY EARNINGS IS ATTRIBUTABLE TO THE 15 PERCENT INCREASE IN THE MINIMUM WAGE EFFECTIVE 1ST JANUARY, 1978, AND HOW MUCH IS DUE TO TIGHTER LABOUR MARKETS. DOES THE FALL IN THE UNEMPLOYMENT RATE FROM 7-1/2 PERCENT IN EARLY 1977 TO 6 PERCENT NOW MEAN INCREASED WAGE PRESSURE IS LIKELY OVER THE COMING YEAR? WHAT ARE THE PROSPECTS FOR A MUCH DELAYED "CATCH-UP" BY THE NON-UNION SECTOR AND WHAT IS THE LOWEST RATE OF UNEMPLOYMENT THE AUTHORITIES NOW VIEW AS COMPATIBLE WITH NON-ACCELERATING PRICE AND WAGE INFLATION?

(B) ON THE PRICE SIDE, THE ADMINISTRATION CURRENTLY PROJECTS A 7 PERCENT RISE IN THE CPI IN THE YEAR TO END-1978, COMPARED WITH 6-3/4 PERCENT FROM DECEMBER 1976 TO DECEMBER 1977. WHAT IS THE ASSUMED IMPACT OF THE DOLLAR'S DEPRECIATION AND OF RISING FOOD PRICES (CURRENTLY FORECAST AT 8-10 PERCENT) IN THIS PROJECTION?

(C) THE COMMITTEE MAY ALSO WISH TO CONSIDER TO WHAT UNCLASSIFIED

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EXTENT THE ANTI-INFLATION PROGRAMME CAN BREAK THE WAGE-PRICE SPIRAL, AND TO WHAT EXTENT OTHER POLICIES MAY BE CALLED FOR.

POTENTIAL OUTPUT

3. SINCE 1973, PRODUCTIVITY HAS GROWN MUCH MORE SLOWLY THAN BEFORE, LARGELY BECAUSE THE EXCEPTIONALLY SHARP DROP OBSERVED IN 1973/74 HAS STILL NOT BEEN MADE UP. AS SIMILAR DEVELOPMENTS HAVE BEEN NOTED IN MANY OTHER OECD COUNTRIES, THE COMMITTEE MAY BE INTERESTED IN HEARING THE EXPLANATIONS OF THE U.S. DELEGATION, AND HOW THE UNITED STATES AUTHORITIES VIEW THE SUGGESTION THAT POTENTIAL OUTPUT IS BOTH LOWER AND GROWING MORE SLOWLY THAN CURRENT OFFICIAL ESTIMATES SUGGEST:

(A) WHAT PART HAS THE LOW INVESTMENT LEVEL SINCE 1974 PLAYED IN THE APPARENT SLOWDOWN OF PRODUCTIVITY?

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(B) WHAT CAN BE DONE TO KEEP INVESTMENT GROWING IF DEMAND
IS NOW SET TO RISE MUCH MORE SLOWLY THAN IN EARLIER
STAGEX OF THE RECOVERY

DEMAND MANAGEMENT

4. THE U.S. DELEGATION AND THE COMMITTEE MAY WANT TO
DISCUSS THE APPROPRIATE STANCE OF DEMAND MANAGEMENT IN
VIEW OF THE SECRETARIAT'S FORECAST.

(A) IS THE PRESENT POLICY MIX-WITH REDUCTIONS IN THE
DEGREE OF FISCAL POLICY STIMULUS BEING COMBINED WITH
SOME TIGHTENING OF MONETARY CONDITIONS--APPROPRIATE
IN CURRENT CIRCUMSTANCES?

(B) WHAT DO CUMMRRENT MONETARY TARGETS IMPLY FOR INTEREST
RATES OVER THE NEXT TWELVE MONTHS, AND HOW ARE THESE
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DEVELOPMENTS LIKELY TO AFFECT OUTPUT AND EMPLOYMENT?

(C) IS THERE A RISK THAT CONTINUED HIGH INFLATION COULD LEAD TO AN EVEN WEAKER OUTCOME THAN CURRENTLY PROJECTED?

II. THE BALANCE OF PAYMENTS

5. GIVEN THE VERY LARGE TRADE DEFICIT, THE COMMITTEE MAY WISH TO DISCUSS THE OUTLOOK FOR THE BALANCE OF PAYMENTS AND CONSIDER THE RELATIVE MERITS OF VARIOUS ADJUSTMENT MECHANISMS:

(A) FURTHER DEPRECIATION OF THE DOLLAR: ARE THE ESTIMATES QUOTED IN THE DRAFT SURVEY (THAT A 5 PERCENT DEPRECIATION REDUCES THE DEFICIT BY ABOUT \$5 BILLION, BUT ADDS 1/2 - 3/4 OF A PERCENTAGE POINT TO THE PRICE LEVEL) WIDELY ACCEPTED?

(B) SPECIFIC MEASURES TO REDUCE OIL IMPORTS: WHAT DOES THE U.S. GOVERNMENT PLAN TO DO, AND WHAT IS THE SIZE AND TIMING OF THE LIKELY EFFECTS?

(C) SLOWER GROWTH IN THE UNITED STATES COMBINED WITH FASTER GROWTH ABROAD: DOES THE U.S. DELEGATION AGREE THAT CONCERTED ACTION ALONG THE LINES PROPOSED BY THE SECRETARIAT COULD PRODUCE AN IMPORTANT IMPROVEMENT IN THE U.S. CURRENT ACCOUNT, AND REDUCE THE RISKS OF A FURTHER DECLINE OF THE DOLLAR?

6. THE COMMITTEE MAY ALSO WISH TO HEAR THE U.S. DELEGATION'S VIEWS ON THE PROSPECTS OF FINANCING THE LIKELY CURRENT ACCOUNT DEFICIT AT CURRENT EXCHANGE RATES IN THE UNCLASSIFIED

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ABSENCE OFF OFFICIAL INTERVENTION. IF THERE IS RENEWED PRESSURE ON THE DOLLAR, WOULD THE U.S. AUTHORITIES SEEK TO INCREASE INTEREST RATES OR BORROW IN FOREIGN CURRENCIES?

CONCLUSIONS

IN SUMMARISING ITS DISCUSSIONS, THE COMMITTEE MAY WANT TO ENDORSE THE FOLLOWING CONCLUSIONS:

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(I) THREE YEARS OF STRONG EXPANSION HAVE SUBSTANTIALLY REDUCED THE DEGREE OF ECONOMIC SLACK IN THE UNITED STATES, AND SOME DECELERATION TO A SUSTAINABLE RATE OF GROWTH IS NOW DESIRABLE. MOREOVER, THE RECENT ACCELERATION OF INFLATION UNDERLINES THE DANGERS OF OVER-AMBITIOUS EMPLOYMENT TARGETS. IN GENERAL PRESENT POLICIES SEEM LIKELY TO ACHIEVE THIS TRANSITION.

(II) THE SUCCESS OF THE PROPOSED ANTI-INFLATION PROGRAMME IS THE KEY TO MAINTAINING A STEADY EXPANSION OF OUTPUT AND CAPACITY IN THE YEARS AHEAD. THE PROPOSED CONSULTATION COULD WELL HAVE A FAVOURABLE IMPACT ON THE UNDERLYING RATE OF INFLATION. NEVERTHELESS, IT MAY PROVE DESIRABLE TO COMPLEMENT THE PROGRAMME WITH MORE DIRECT COST-REDUCING MEASURES AND WITH TAX POLICIES DESIGNED TO FOSTER WAGE AND PRICE MODERATION IN THE PRIVATE SECTOR.

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(III) THE UNITED STATES AND HER MAJOR TRADING PARTNERS HAVE A COMMON INTEREST IN REDUCING THE CURRENT DEFICIT WITHOUT EXCESSIVE AND DISRUPTIVE CHANGES

IN THE EXCHANGE RATE. THUS ANY NECESSARY ADJUST-
MENTS OF THE EXCHANGE RATE NEEDS TO BE SUPPORTED
BY EFFECTIVE ENERGY LEGISLATION IN THE UNITED
STATES AND BY FASTER GROWTH IN THOSE COUNTRIES
IN LARGE BALANCE-OF-PAYMENTS SURPLUS AND WITH
COMPARATIVE PRICE STABILITY.

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